

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-91935; File No. SR-OCC-2021-004)

May 19, 2021

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of Proposed Rule Change Relating to Revisions to OCC's Auction Participation Requirements

I. INTRODUCTION

On March 19, 2021, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2021-004 (“Proposed Rule Change”) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to amend the auction participation requirements set forth in Interpretation and Policy (“I&P”) .02(c) to OCC Rule 1104 (Creation of Liquidating Settlement Account).³ The Proposed Rule Change was published for public comment in the Federal Register on April 6, 2021.⁴ The Commission has received no comments regarding the Proposed Rule Change. This order approves the Proposed Rule Change.

II. BACKGROUND

The Proposed Rule Change by OCC would change I&P .02(c) to OCC Rule 1104 in order to clarify and streamline the process of on-boarding Clearing Members and non-Clearing Members as potential bidders in future auctions of a suspended Clearing Member's remaining portfolio.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing infra note 4, 86 Fed. Reg. at 17868.

⁴ Securities Exchange Act Release No. 91445 (Mar. 31, 2021), 86 Fed. Reg. 17868 (Apr. 6, 2021) (File No. SR-OCC-2021-004) (“Notice of Filing”).

Under OCC's current Rules, following the suspension of any Clearing Member, OCC may take a number of steps designed to reasonably ensure that the Clearing Member's suspension is managed in an orderly fashion. Such steps may include liquidating the remaining collateral, open positions, and/or exercised/matured contracts (i.e., the remaining portfolio) of the suspended Clearing Member. I&P .02(a) to OCC Rule 1104 clarifies that OCC "may elect to use one or more private auctions to liquidate all or any part" of a suspended Clearing Member's remaining portfolio. In this context, the term "private auction" means an auction open to bidders who are invited by OCC and in which such bidders submit bids on a confidential basis.⁵

I&P .02(c) to Rule 1104 establishes certain basic requirements for the prequalification of bidders who may participate in OCC's private auction process. I&P .02(c) states that OCC "will invite all Clearing Members to apply to become pre-qualified auction bidders" and that "[a]ny Clearing Member may be included in the pool of pre-qualified auction bidders by completing required auction documentation in advance." Further, I&P .02(c) states that "[b]y posting notices on the [OCC]'s website from time to time, [OCC] will also invite non-Clearing Members to apply to become pre-qualified auction bidders." I&P .02(c) establishes that for a non-Clearing Member to be pre-qualified as an auction bidder, it "must (i) actively trade in the asset class in which it proposes to submit bids, (ii) actively trade in markets cleared by [OCC], (iii) be sponsored by, and submit its bids through, a Clearing Member that has agreed to guarantee and settle any accepted bid made by such non-Clearing Member and (iv) complete required auction documentation in advance." I&P .02(c) also states that OCC "will endeavor to maintain a pool of pre-qualified auction bidders by periodically reviewing such bidders and their qualifications" and that OCC "will promptly notify any pre-qualified auction bidder removed from the pool of

⁵ Interpretation and Policy .02(a) to OCC Rule 1104.

pre-qualified auction bidders.”

OCC proposes to revise I&P .02(c) to eliminate the requirement that Clearing Members must first be invited by OCC before Clearing Members may apply to become pre-qualified auction bidders. Instead, the revised language in I&P .02(c) would state that all Clearing Members are invited to participate in auctions of a suspended Clearing Member’s remaining portfolio. The proposed revisions would retain the current requirement that, in order for a Clearing Member to be pre-qualified as an auction bidder, the Clearing Member would need to complete any required auction documentation in advance.

OCC also proposes to revise I&P .02(c) to reflect that non-Clearing Members, in order to become pre-qualified auction bidders, would no longer need OCC to post invitation notices to its website from time to time. The proposed revisions to I&P .02(c) would also remove the existing requirements that a non-Clearing Member must actively trade in the asset class in which it proposes to submit bids and must actively trade in markets cleared by OCC. OCC proposes to remove trade activity requirements because of its concern that the trading activity review process contemplated by I&P .02(c) could inappropriately limit the number of pre-qualified bidders by excluding, *inter alia*, prospective bidders who did not have sufficient trading activity that was visible to OCC at the time of pre-qualification or review but were suitable bidders at the time of a particular auction.⁶ The proposed revisions would retain the other existing requirements that, to become a pre-qualified auction bidder, a non-Clearing Member would need to (i) have a Clearing Member sponsor to submit bids on behalf of the non-Clearing Member, (ii) have a Clearing Member agree to guarantee and settle any accepted bid made by the non-Clearing Member, and (iii) complete any required auction documentation in advance.

⁶ See Notice of Filing *supra* note 4, 86 Fed. Reg. at 17869.

Additionally, OCC proposes to remove two sentences related to the administration of OCC's pool of pre-qualified auction bidders. Currently, I&P .02(c) explains that OCC maintains a pool of pre-qualified auction bidders, periodically reviews the pool of such bidders and their qualifications, and notifies any pre-qualified auction bidder that is removed from the pool. OCC proposes to remove the two sentences because OCC asserts that the revised text would eliminate the need for a periodic review and removal process. With the proposed revisions, a Clearing Member that terminates its required auction documentation or ceases to maintain its status as a Clearing Member would no longer be considered a pre-qualified auction bidder. Likewise, a non-Clearing Member whose Clearing Member sponsorship or guarantee is revoked or whose required auction documentation is terminated would no longer be considered a pre-qualified bidder.⁷

The Proposed Rule Change would not make any changes to I&P .02(d) to Rule 1104, which describes the steps that OCC takes to select bidders to participate in a private auction, taking into consideration certain criteria. These criteria include the bidder's (and/or, in the case of a non-Clearing Member bidder, its sponsor Clearing Member's) financial strength, demonstrated activity in the products being auctioned and qualification to clear transactions in the asset class in which it proposes to submit bids.⁸ OCC notes that it would continue to perform this pre-auction review as described in I&P .02(d) because it would allow OCC to select bidders for a particular auction based on an objective review that gives due consideration to the specific

⁷ OCC notes that it would continue its current practice of maintaining a list of pre-qualified bidders through OCC's default management testing and review of default management testing results. Id.

⁸ Interpretation and Policy .02(d) to OCC Rule 1104.

portfolio that would be auctioned. OCC also believes that reviewing the criteria set forth in I&P .02(d) with respect to a particular auction is the most appropriate way for OCC to identify, monitor, and manage the material risks arising from a non-Clearing Member auction participant in accordance with Rule 17Ad-22(e)(19).⁹

III. DISCUSSION AND COMMISSION FINDINGS

Section 19(b)(2)(C) of the Exchange Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such organization.¹⁰ After carefully considering the Proposed Rule Change, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act,¹¹ and Rule 17Ad-22(e)(13)¹² thereunder, as described in detail below.

A. Consistency with Section 17A(b)(3)(F) of the Exchange Act

Section 17A(b)(3)(F) of the Exchange Act requires that the rules of a clearing agency be designed to, among other things, assure the safeguarding of securities and funds which are in the

⁹ See Notice of Filing supra note 4, 86 Fed. Reg. at 17870. Rule 17Ad-22(e)(19) requires OCC to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risks to OCC arising from arrangements in which firms that are indirect participants in the covered clearing agency rely on the services provided by direct participants to access the covered clearing agency's payment, clearing, or settlement facilities. See 17 CFR 240.17Ad-22(e)(19).

¹⁰ 15 U.S.C. 78s(b)(2)(C).

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

¹² 17 CFR 240.17Ad-22(e)(13).

custody or control of the clearing agency or for which it is responsible.¹³ Based on its review of the record, and for the reasons described below, the Commission believes that the proposed changes to revise OCC's auction participation requirements as described above is consistent with assuring the safeguarding of securities and funds currently in OCC's custody and control, because the proposed modifications would enhance OCC's ability to hold robust, efficient auctions that would improve the likelihood of the clearing agency having sufficient resources to cover potential credit losses under adverse market conditions.

OCC proposes to revise I&P .02(c) so that all Clearing Members are eligible to become pre-qualified bidders, without requiring invitations from OCC beforehand. This change would help to ensure that Clearing Members understand that receiving an invitation from OCC beforehand is not an administrative obstacle to auction participation. This should help facilitate the on-boarding process for Clearing Members, which in turn could lead to increased Clearing Member participation in the auctions. Second, the proposal to remove administrative obstacles to non-Clearing Member auction participation—specifically, by removing the OCC invitation notice requirement on OCC's website and trading activity requirements to pre-qualify as a bidder generally, since trading activity would be considered later as part of a selection process for participation in a specific auction—could also encourage more non-Clearing Members to become bidders, and increase the number of participants in private auctions overall. Appropriate safeguards would remain in place for non-Clearing Member participation, as OCC would still require a non-Clearing Member to (i) have a Clearing Member sponsor submit bids on behalf of the non-Clearing Member, (ii) have a Clearing Member agree to guarantee and settle any accepted bid made by the non-Clearing Member, and (iii) complete any required auction

¹³ 15 U.S.C. 78q-1(b)(3)(F).

documentation in advance to become a pre-qualified bidder. By retaining these non-Clearing Member participation requirements, OCC would have the necessary information to continue performing pre-auction reviews of all bidders, whether Clearing Member or non-Clearing Member, on a case-by-case basis using the criteria established in I&P .02(d).

Increasing the total number of auction participants would promote competition and likely generate more competitive bids, which would in turn increase the likelihood that OCC would be able to sell the defaulting Clearing Member's portfolio at a more favorable price. This would minimize OCC's need to draw upon Clearing Members' collateral in OCC's custody or control in the event of a Clearing Member default. Therefore, the Commission believes that the proposal is consistent with assuring the safeguarding of securities and funds which are in OCC's custody or control.

The Commission believes, therefore, that the proposal to modify the auction participation requirements for Clearing Members and non-Clearing Members is consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.¹⁴

B. Consistency with Rule 17Ad-22(e)(13) under the Exchange Act

Rule 17Ad-22(e)(13) under the Exchange Act requires OCC to establish, implement, maintain, and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands.¹⁵

Based on its review of the record, and for the reasons described below, the Commission believes that the proposed changes described above are consistent with Rule 17Ad-22(e)(13)

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

¹⁵ 17 CFR 240.17Ad-22(e)(13).

under the Exchange Act. The proposed changes would facilitate on-boarding of potential bidders by removing certain administrative steps in the process of becoming a pre-qualified auction bidder. For example, the proposal would remove an administrative step so that Clearing Members would not need OCC's initial invitation for consideration as a pre-qualified bidder. As long as a Clearing Member completes the required documentation in advance, the Clearing Member could be considered for the pre-qualified bidder pool. Meanwhile, OCC proposes to remove the initial step for OCC to post a website invitation notice to non-Clearing Members from time to time, and to remove existing limitations on non-Clearing Members seeking to become pre-qualified bidders (e.g., that a non-Clearing Member must currently fulfill certain trading activity requirements to pre-qualify as a bidder generally, as opposed to having its trading activity considered later during a selection process for participation in a specific auction). Additionally, OCC's proposal to eliminate periodic reviews of the pre-qualified bidder pool and the accompanying removal process would simplify the administration of pre-qualified bidders, as it would eliminate a bidder review process that appears duplicative in purpose to the I&P .02(d) pre-auction reviews that OCC has stated it would continue to perform.¹⁶

Removing administrative obstacles to the bidder on-boarding process would increase the likelihood that OCC would have a large enough bidder pool and the operational capacity to hold efficient, competitive auctions in a timely manner, and as a result cover losses and meet liquidity demands promptly. The Commission believes, therefore, that the proposal to modify

¹⁶ The Commission also believes that in the case of non-Clearing Member auction participants, OCC will continue to meet the requirements of Rule 17Ad-22(e)(19) regarding "indirect participants," as OCC intends to continue performing the I&P .02(d) pre-auction reviews for both Clearing Member and non-Clearing Member participants. See 17 CFR 240.17Ad-22(e)(19).

auction participant requirements for Clearing Members and non-Clearing Members is consistent with the requirements of Rule 17Ad-22(e)(13) under the Exchange Act.¹⁷

IV. CONCLUSION

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Exchange Act, and in particular, the requirements of Section 17A of the Exchange Act¹⁸ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,¹⁹ that the Proposed Rule Change (SR-OCC-2021-004) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

J. Matthew DeLesDernier
Assistant Secretary

¹⁷ 17 CFR 240.17Ad-22(e)(13).

¹⁸ In approving this Proposed Rule Change, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).